

ANALYSIS OF ORIGINAL BILL

Author: Kaloogian Analyst: Jeani Brent Bill Number: AB 2108
Related Bills: SB 1613 (1998) Telephone: 845-3410 Introduced Date: 02/18/98

Attorney: Doug Bramhall Sponsor:

SUBJECT: Conformity to Federal HOPE Scholarship Credit/FTB to Report Fiscal Impact to Legislature

SUMMARY

This bill would conform California law to the federal non-refundable HOPE Scholarship credit contained in the federal 1997 Taxpayer Relief Act (TRA).

This bill also would require the department to report to the Legislature on or before July 1, 2000, the fiscal impact of conformity to the HOPE credit.

EFFECTIVE DATE

This bill would go into immediate effect and would be operative for taxable years beginning on or after January 1, 1998.

SPECIFIC FINDINGS

Under existing federal law, as enacted by the TRA, individual taxpayers are allowed to claim a non-refundable HOPE credit against federal income taxes. The HOPE credit rate is 100% on the first \$1,000 of qualified tuition and fees and 50% on the next \$1,000 of qualified tuition and fees. The HOPE credit is available only for tuition and fees required for the enrollment or attendance of an eligible student at an eligible institution and is not available for expenses incurred to purchase books or for room and board. For each taxable year, a taxpayer must elect with respect to an eligible student either the HOPE credit, the lifetime learning credit, or the exclusion from gross income for certain distributions from an education IRA.

The HOPE credit is not available to married taxpayers filing separate returns. Married taxpayers must file joint tax returns to qualify for the credit.

The HOPE credit is for tuition and fees paid for the first two years of the student's post-secondary education in a degree or certificate program. The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent. Beginning in 2001, the maximum credit amount of \$1,500 will be indexed for inflation, rounded down to the closest multiple of \$50.

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___X___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO ___

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department Director

Gerald H. Goldberg

3/9/98

Agency Secretary

Date

By:

Date:

The HOPE credit may not be claimed against a taxpayer's alternative minimum tax (AMT) liability. The HOPE credit amount that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified AGI between \$40,000 and \$50,000 (\$80,000 and \$100,000 for joint returns). Modified AGI includes amounts otherwise excluded with respect to income earned abroad (or income from Puerto Rico or U.S. possessions). The income phase-out ranges will be indexed for inflation occurring after the year 2000, rounded down to the closest multiple of \$1,000. The HOPE credit is available in the taxable year the expenses are paid, subject to the requirement that the education commence or continue during that year or during the first three months of the next year. Qualified tuition expenses paid with the proceeds of a loan generally are eligible for the HOPE credits (rather than repayment of the loan itself).

The Internal Revenue Service is granted authority to issue regulations providing that the HOPE credit will be recaptured in cases where the student or taxpayer receives a refund of tuition and related expenses with respect to which a credit was claimed in a prior year.

If a student is claimed as a dependent by the parent or other taxpayer, the eligible student is not entitled to claim a HOPE credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of this provision.

For each taxable year, a taxpayer may elect with respect to an eligible student either the HOPE credit, the lifetime learning credit, or the exclusion from gross income for certain distributions from an education IRA. Thus, for example, if a parent claims a child as a dependent for a taxable year, then all qualified tuition expenses paid by both the parent and child are deemed paid by the parent, and the parent may claim the HOPE credit (assuming that the AGI phaseout does not apply) on the parent's return.

- Qualified Tuition and Fees

The HOPE credit is available for "qualified tuition and related expenses," meaning tuition and fees required for the enrollment or attendance of an eligible student at an eligible educational institution, as defined. The credit is not available for expenses incurred to purchase books. Charges and fees associated with meals, lodging, student activities, athletics, insurance, transportation, and similar personal, living or family expenses are also not included. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and fees generally include only out-of-pocket expenses. Qualified tuition and fees do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and fees are reduced by any scholarship or fellowship grants excludable from gross income under present-law and any other tax-free educational benefits received by the student during the taxable year. No reduction of qualified

tuition and fees is required for a gift, bequest, devise, or inheritance. A HOPE credit is not allowed with respect to any education expense for which a deduction is claimed as a business expense or under any other section of the Internal Revenue Code.

- Coordination with U.S. Savings Bonds

The TRA of 1997 amended the exclusion from income of interest earned from federal savings bonds if used for higher education to provide that the amount of qualified higher education expenses taken into account for that purpose is reduced by the amount of the expenses taken into account in determining the HOPE credit or the lifetime learning credit claimed by any taxpayer with respect to the student for the taxable year.

- Eligible Student

An eligible student for purposes of the HOPE credit is an individual who is enrolled in a degree, certificate, or other program (including a program of study abroad approved for credit by the institution at which such student is enrolled) leading to a recognized educational credential at an eligible educational institution. The student must pursue a course of study for at least one academic period that begins during the taxable year and must carry at least one-half the normal full-time workload for the course of study the student is pursuing. In addition, an eligible student may not have been convicted of a federal or state felony consisting of the possession or distribution of a controlled substance.

- Eligible Educational Institutions

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

This bill would conform California law to the federal HOPE credit, allowing California taxpayers a credit of 100% on the first \$1,000 of qualified tuition and fees and 50% on the next \$1,000 of qualified tuition and fees.

This bill also would require the department to report to the Legislature on or before July 1, 2000, the fiscal impact of conformity to the HOPE credit.

Policy Consideration

The federal credit allows taxpayers to claim 100% of the first \$1,000 of qualified tuition and fees. This bill would allow an identical credit under state law, thereby effectively doubling the amount of allowable credit – 200% of the first \$1,000 of qualified tuition for the combined credits.

The language in this bill would not include certain rules provided by the federal HOPE Scholarship credit. Because this bill specifically conforms to

subdivision (a)(1) of Internal Revenue Code Section 25A, it would not conform to the following rules:

1. The limitation based on modified adjusted gross income provided in IRC 25A(d);
2. The definitions of "qualified tuition and related expenses" and "eligible educational institution" provided in IRC 25A(f);
3. Special rules regarding identification requirements, scholarship adjustments, treatment of expenses paid by the dependent, treatment of certain prepayments, denial of double benefit, married individuals filing separate returns, and nonresident aliens; and
4. Inflation adjustments.

In addition, since the federal HOPE credit is only allowable if the taxpayer affirmatively elects to have the section apply, and that election is contained in IRC Section 25A(e), to which this bill would not conform, no taxpayer could claim the HOPE credit under this bill as currently drafted.

Neither the federal HOPE credit nor the credit created by this bill have a sunset date. Credits are typically enacted with a sunset date so that the Legislature can review their effectiveness.

This credit would not be limited to taxpayers who are residents of California.

Implementation Consideration

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Consideration

This bill does not specify an operative date. While the Personal Income Tax Law provides rules that would make this bill's provisions apply to taxable years beginning on or after January 1, 1998, it is standard to include operative date language in credit provisions, such as For each taxable year beginning on or after January 1, 1998, there shall be allowed . . .

LEGISLATIVELY MANDATED REPORTS

This bill would require the department to report to the Legislature on or before July 1, 2000, the fiscal impact of the HOPE Scholarship credit.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Revenue losses from this provision are estimated as follows:

Estimated Revenue Impact AB 2108 Taxable Years Beginning 1/1/98 Assumed Enactment After 6/30/98 (In Millions)		
1998-9	1999-0	2000-01
(\$95)	(\$80)	(\$80)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

These estimates were derived from information from the California Postsecondary Education Commission on student profiles and costs, combined with state tax return data on income and tax liability distributions. For 1998 it is projected approximately 200,000 returns will claim the HOPE credit.

BOARD POSITION

Pending.